Office - Supreme Court, U.S.
FILED
NOV 8 1982
ALEXANDER L. STEVAS
CLERK

No. 82-404

In the Supreme Court of the United States

OCTOBER TERM, 1982

HILTON HOTELS CORPORATION, SUCCESSOR TO FLAMINGO RESORT, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

Page

Cases:

Automobile Club v. *Commissioner*, 353 U.S. 180 7

Automobile Insurance Co. v. *Commissioner*, 72 F.2d 265 4

Barker v. *Magruder*, 95 F.2d 122 4

Barker v. *United States*, 26 F. Sup. 1004 4

Brown v. *Helvering*, 291 U.S. 193 7

Continental Tie & Lumber Co. v. *United States*, 286 U.S. 290 ..... 3, 4

Desert Palace, Inc. v. *Commissioner*, 72 T.C. 1033, appeal pending, No. 82-7091 (9th Cir. filed Feb. 12, 1982) 6

Dixon v. *United States*, 381 U.S. 68 7

Eastman Kodak Co. v. *United States*, 534 F.2d 252 4

Marquardt Corp. v. *Commissioner*, 39 T.C. 443 5

Nightingale v. *United States*, 684 F.2d 611 7

Schlude v. *Commissioner*, 327 U.S. 128 4

Travis v. *Commissioner*, 406 F.2d 987 4

United States v. *Anderson*, 269 U.S. 422 3

United States v. *Byrum*, 408 U.S. 125 5

Page

Statute and regulations:

Transportation Act of 1920, ch. 91, Section 204, 41 Stat. 460 3

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

Section 1.446-1(c)(ii) 3
Section 1.451-1(a) 3

In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-404

HILTON HOTELS CORPORATION, SUCCESSOR TO FLAMINGO RESORT, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner seeks review of the decision in this federal income tax case that obligations incurred by gambling customers at a licensed Nevada casino owned by petitioner's predecessor in interest (Flamingo Resort, Inc.) were so fixed, unconditional, and definite as to require that they be accrued by Flamingo for income tax purposes even though the obligations were subject to the affirmative defense under Nevada law that they were gambling debts and therefore not legally enforceable.

The relevant facts may be summarized as follows: Flamingo operated a legal gambling casino in Las Vegas, Nevada, during the year 1967. In connection with its gambling operations, Flamingo extended credit in the form of cash or gambling chips to selected patrons, who executed "markers" in the form of counterchecks in return for the credit (Pet.

App. 3). Approximately 60% of Flamingo's casino play resulted from such extensions of credit (*id.* at 3, 8). According to Flamingo's own estimates, it collected approximately 96% of its casino receivables even though the receivables were not legally enforceable in the state courts (*ibid.*).

Flamingo prepared its income tax returns on the accrual basis but did not include the casino receivables in its income (Pet. App. 2). Instead, it reported the receivables only at the time they were paid. On audit, the Internal Revenue Service concluded that the receivables should be accrued as income. After permitting an appropriate allowance for a reserve for bad debts, the Service determined a deficiency in petitioner's 1967 income taxes of $261,942.65. In this refund suit brought by petitioner in the United States District Court for the District of Nevada, the district court granted summary judgment for the government, holding that the receivables were accruable despite their legal unenforceability (*ibid.*).

The court of appeals affirmed (*id.* at 9). It pointed out that the obligations of Flamingo's patrons were in practical effect as fixed as possible, that the amounts owed Flamingo could be determined with reasonable accuracy, and that the history of Flamingo's business demonstrated that there was a reasonable expectation of collection. In such circumstances, the court concluded, the absence of legal enforceability did not prevent accrual of Flamingo's receivables (*id.* at 7-9).

1. The decision below correctly held that petitioner was required to accrue into income the obligations of its gambling customers, less an appropriate allowance for bad debts.

Under the accrual method of reporting income employed by Flamingo, "income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with

reasonable accuracy." Treasury Regulations on Income Tax (1954 Code), Section 1.451-1(a) (26 C.F.R.). See also Treasury Regulations, Section 1.446-1(c)(ii). This rule, known as the "all events" test, derives from this Court's decision in *United States* v. *Anderson*, 269 U.S. 422 (1926). There, the Court held that a tax on profits from the sale of munitions was accruable (and hence deductible) in the year the munitions were sold and not the following year when the tax became due. The Court rejected the contention that the tax could not be accrued as an expense prior to its assessment, stating (269 U.S. at 441): "In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it."

Anderson therefore makes it clear that legal liability for an expense, or legal enforceability of a right to income, is not always a prerequisite for the accrual of an expense or an item of income. Subsequent to *Anderson*, the decisions of this Court and other courts further demonstrate the correctness of the rule requiring petitioner to accrue the obligations incurred by its customers. For example, in *Continental Tie & Lumber Co.* v. *United States*, 286 U.S. 290 (1932), income was paid to the taxpayer's railroad subsidiary in 1923 as an award by the Interstate Commerce Commission pursuant to Section 204 of the Transportation Act of 1920, ch. 91, 41 Stat. 460, for lost revenues during a period of government control of the railroads. Although the taxpayer contended that the award was accruable in 1923, the year the award was determined and paid, the government contended that the amount was accruable in 1920. Although this Court agreed with the taxpayer that in 1920 "no proceeding was available to compel an allowance [of the award], or to determine the elements which should enter

into the calculation," it nevertheless held that the unenforceable award should be accrued in 1920 (286 U.S. at 295): "The right to the award was fixed by the passage of the Transportation Act. * * * Petitioner's right to payment ripened when the act became law" (*ibid.*). This Court thus rejected the taxpayer's argument that its unenforceable claim did not amount to a fixed right to income for purposes of the "all events" test.[1]

The courts of appeals are in accord with the foregoing analysis. In *Barker* v. *Magruder*, 95 F. 2d 122, 123 (D.C. Cir. 1938), the court rejected the argument that usurious interest, unenforceable under District of Columbia law, was not accruable as income because "the government should not be permitted to tax, under the claim of income, an amount of which, under the law, the taxpayer cannot enforce payment." In holding that such interest was properly accruable, the court stated (*id.* at 122), "[t]he correct answer, as we think, depends not so much, as appellants urge, upon the legal right to enforce collection as upon the existing probability of its being received." The Court of Claims reached the same conclusion with respect to the accruability of usurious interest. *Barker* v. *United States*, 26 F. Supp. 1004 (1939). Likewise, in *Automobile Insurance Co.* v. *Commissioner*, 72 F. 2d 265, 268 (2d Cir. 1934), the court upheld accruability of wartime damages payable by the Mixed Claims Commission, even though such payment was not enforceable by the taxpayer. *Travis* v. *Commissioner*, 406 F. 2d 987 (6th Cir. 1969), is to the same effect. There, the court held that the taxpayer was required to accrue amounts due it on installment contracts for dance lessons even though under state law the right to

---

[1] A similar argument was presented to this Court on brief in *Schlude* v. *Commissioner*, 372 U.S. 128 (1963). Although the Court did not discuss it, its decision requiring accrual necessarily rejected it. See also *Travis* v. *Commissioner*, 406 F. 2d 987, 989 (6th Cir. 1969).

receive the installments was not legally enforceable because the contracts were executory. See also *Eastman Kodak Co.* v. *United States*, 534 F. 2d 252, 257 (Ct. Cl. 1976) ("The 'all events' test * * * looks to a liability that is so fixed that the fact of liability is certain and the amount thereof reasonably ascertainable, *although not necessarily legally enforceable*" (emphasis supplied)).

On the other hand, none of the cases cited by petitioner (Pet. 14-15) holds that where, as here, all events fixing a taxpayer's right to income have occurred, the income still is not accruable unless and until the right is legally enforceable. As the district court correctly pointed out (Pet. App. 23-24), the cases upon which petitioner relied below fall into three categories: (1) those in which the taxpayer still had to perform some act in order to bind the other party to the obligation; (2) those in which the claim to income was the subject of actual controversy, as to either liability or amount, during the year at issue, such as *Marquardt Corp.* v. *Commissioner*, 39 T.C. 443 (1962) (Pet. 14); and (3) those in which the contractual income was subject to final determination upon completion. Since this case fits into none of these categories, petitioner's cited authorities are distinguishable.[2]

2. The courts below properly applied the "all events" test to the facts of this case. All the events fixing Flamingo's right to the casino receivables occurred at the time Flamingo provided its patrons with cash or gambling chips on credit and the patrons simultaneously acknowledged their obligations by executing "markers." No further act on the part of Flamingo was required to fix its right to payment of the indebtedness represented by the "markers", the amounts

---

[2]Petitioner's reliance (Pet. 11-12) upon *United States* v. *Byrum*, 408 U.S. 125, 136-137 (1972), is also misplaced. The Court's statement there that the term "right" in an estate tax context connotes a legally enforceable power has no bearing on the tax accrual question at issue here.

owed to it could be determined with reasonable accuracy, and there was more than a reasonable expectation of collection. Indeed, according to Flamingo's own estimates, its collection rate on the receivables ranged as high as 96% (Pet. App. 3, 8). In these circumstances, the decision below correctly held that Flamingo's inability to resort to the state courts for enforcement of its fixed right to the casino receivables is not controlling (*id.* at 9).[3] Accordingly, the courts below correctly held that on the facts here Flamingo was required to accrue its receivables notwithstanding their legal unenforceability. Indeed, petitioner's argument that the "all events" test is not satisfied until actual payment occurs is tantamount to seeking cash basis treatment for its income from "markers" even though it is an accrual basis taxpayer.[4]

3. Moreover, as the court of appeals correctly recognized (Pet. App. 9 n.5), it is not of controlling significance that the Commissioner originally conceded in *Desert Palace, Inc.* v. *Commissioner*, 72 T.C. 1033 (1979), appeal pending, No. 82-7091 (9th Cir. filed Feb. 12, 1982), that the lack of legal enforceability precluded the accrual of the casino receivables in that case.[5] As this Court has made clear, the

---

[3]As the court of appeals noted (Pet. App. 8), it is doubtful that legal enforceability of the "markers" would or could increase Flamingo's recovery rate. Moreover, the fact that Flamingo conducted the majority of its business (approximately 60%) through extension of credit to its patrons is telling evidence that the lack of legal enforceability of gambling obligations had no practical effect on its operations (Pet. App. 3, 8).

[4]The contrary result urged by petitioner would in effect place casino owners on a hybrid system of accounting under which they would enjoy the dual benefits of reporting a substantial portion of their receipts on the cash basis while continuing to report all their expenses on the accrual basis.

[5]Following the district court's decision in this case, the Commissioner reconsidered his concession in *Desert Palace* and concluded that it had been made in error. Accordingly, he filed a motion requesting the Tax Court to reconsider its decision in *Desert Palace*. The Tax Court, however, denied the motion.

Commissioner is free to change his position if he determines that his prior position was in error. See *Automobile Club* v. *Commissioner*, 353 U.S. 180 (1957); *Dixon* v. *United States*, 381 U.S. 68 (1965).

Finally, there is no basis for petitioner's concern (Pet. 18-21) that the decision below will authorize the deduction of reserves for future expenses (heretofore prohibited) and will thereby result in a tremendous drain on the Treasury. Such reserves are not accruable for tax purposes because they represent contingent liabilities as to which all the events necessary to fix each individual instance of liability have not occurred even though the amount of future liabilities may be highly predictable in the aggregate. Reserves for future expenses thus do not satisfy the "all events" test. Nothing in the decision below leads to a contrary conclusion. See *Brown* v. *Helvering*, 291 U.S. 193 (1934); *Nightingale* v. *United States*, 684 F. 2d 611, 614-615 (9th Cir. 1982). Here, all the events other than actual cash payment have occurred. Since the liabilities in question are not contingent, they were properly accruable in petitioner's income.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

NOVEMBER 1982

DOJ-1982-11